

COMPANIES ACT 2006

EXPLANATORY NOTES

EXISTING LAW

Scotland

488. Under Scots law, the member's right to raise an action is conferred by substantive law. Accordingly, a member has title as a matter of substantive law to raise proceedings in respect of a director's breach of duty to obtain a remedy for the company. The action is raised in the name of the member but the remedy is obtained for the company and the rights which the member can enforce against a director or third party are those of the company.
489. The member's right arises where the action complained of is fraudulent or ultra vires and so cannot be validated by a majority of the members of the company. This remedy is not available if the majority of members acting in good faith have validated or may validate the act complained of.
490. Two rules of substantive law apply to actions brought by the member to protect the company's interests (as well as to actions brought to protect the shareholder's personal interests such as enforcement of rights in the articles of association). First, the directors of a company owe duties to the company and not to the members. Second, the court will not interfere in matters of internal management which may be sanctioned by a majority of the members. The effect of these rules is similar to the first two legs of the rule in *Foss v Harbottle*.

Chapter 1: Derivative Claims in England and Wales Or Northern Ireland

491. The sections in this Part do not formulate a substantive rule to replace the rule in *Foss v Harbottle*, but instead reflect the recommendation of the Law Commission that there should be a "new derivative procedure with more modern, flexible and accessible criteria for determining whether a shareholder can pursue an action" (*Shareholder Remedies*, paragraph 6.15). In line with the recommendations of the Law Commission, the derivative claim will be available for breach of the duty to exercise reasonable care, skill and diligence, even if the director has not benefited personally, and it will not be necessary for the applicant to show that the wrongdoing directors control the majority of the company's shares.
492. The sections in Chapter 1 of this Part introduce a two-stage procedure for permission to continue a derivative claim. At the first stage the applicant will be required to make a *prima facie* case for permission to continue a derivative claim and the court will be required to consider the issue on the basis of the evidence filed by the applicant only, without requiring evidence from the defendant. The courts must dismiss the application if the applicant cannot establish a *prima facie* case. At the second stage – but before the substantive action begins – the court may require evidence to be provided by the company. The sections set out a list of the matters which the court must take into account in considering whether to give permission and the circumstances in which the court is bound to refuse permission.

493. The sections will be supplemented by amended Civil Procedure Rules.

Section 260: Derivative claims

494. This section sets out the key aspects of a derivative claim.

- *Subsection (1)* defines what is meant by a derivative claim. There are three elements to this: the action is brought by a member of the company; the cause of action is vested in the company; and relief is sought on the company's behalf. (A "member" is defined in section 112. *Subsection (5)* provides that references to a member in this Chapter include a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law, for example where a trustee in bankruptcy or personal representative of a deceased member's estate acquires an interest in a share as a result of the bankruptcy or death of a member).
- *Subsection (2)* provides that the claim may only be brought either under this Chapter or in pursuance of an order of the court in proceedings under section 994 (proceedings for protection of members against unfair prejudice).
- *Subsection (3)* provides that a derivative claim "may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company". As such, a derivative claim may be brought in respect of an alleged breach of any of the general duties of directors in Chapter 2 of Part 10, including the duty to exercise reasonable care, skill and diligence (section 174).
- *Subsection (3)* also provides that the cause of action may be against the director or against a third party, or both. Derivative claims against third parties would be permitted only in very narrow circumstances, where the damage suffered by the company arose from an act involving a breach of duty etc on the part of the director (e.g. for knowing receipt of money or property transferred in breach of trust or for knowing assistance in a breach of trust).
- *Subsection (4)* provides that a derivative claim may be brought by a member in respect of wrongs committed prior to his becoming a member. This reflects the fact that the rights being enforced are those of the company rather than those of the member and is the position at common law.
- Under *subsection (5)*, the reference to a director in this Chapter includes a former director; and a shadow director is treated as a director.

Section 261: Application for permission to continue derivative claim

495. This clause provides that, once proceedings have been brought, the member is required to apply to the court for permission to continue the claim. This reflects the current procedure in England and Wales under the Civil Procedure Rules. The applicant is required to establish a *prima facie* case for the grant of permission, and the court will consider the issue on the basis of his evidence alone without requiring evidence to be filed by the defendant. The court must dismiss the application at this stage if what is filed does not show a *prima facie* case, and it may make any consequential order that it considers appropriate (for example, a costs order or a civil restraint order against the applicant). If the application is not dismissed, the court may direct the company to provide evidence and, on hearing the application, may grant permission, refuse permission and dismiss the claim, or adjourn the proceedings and give such directions as it thinks fit. This will enable the courts to dismiss unmeritorious claims at an early stage without involving the defendants or the company.

Section 262: Application for permission to continue claim as a derivative claim

496. This section addresses the possibility that, where a company has brought a claim and the cause of action on which the claim is based could be pursued by a member as a derivative action:
- the manner in which the company commenced or continued the claim may amount to an abuse of process (e.g. the company brought the claim with a view to preventing a member bringing a derivative claim);
 - the company may fail to prosecute the claim diligently; and
 - it may be appropriate for a member to continue the claim as a derivative claim;
497. The section provides that, in these circumstances, a member may apply to the court to continue the claim as a derivative action.

Section 263: Whether permission to be given

498. This section sets out the criteria which must be taken into account by the court in considering whether to give permission to continue a derivative claim.
499. *Subsection (2)* provides that the court must refuse leave to continue a derivative claim if it is satisfied that:
- a) a person acting in accordance with the general duty of directors to promote the success of the company (section 172) would not seek to continue the claim; or
 - b) the act or omission giving rise to the cause of action has been authorised or ratified by the company. Section 180(4) preserves any rule of law enabling the company to give authority for anything that would otherwise be a breach of duty. Section 239 preserves the current law on ratification of acts of directors, but with one significant change. Any decision by a company to ratify conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be taken by the members, and without reliance on the votes in favour by the director or any connected person.)
500. *Subsection (3)* sets out the criteria which the court must, in particular, take into account in considering whether or not to grant permission for the derivative claim to be continued.
501. *Subsection (4)* provides that, in considering whether to give permission, the court must have particular regard to any evidence before it as to the views of independent members of the company i.e. members who have no personal interest, direct or indirect in the matter.
502. *Subsection (5)* confers on the Secretary of State a power to make regulations with regard to the criteria to which the court must have regard in determining whether to grant leave to continue a derivative claim and where leave of the court must be refused. *Subsection (6)* provides that, before making any such regulations, the Secretary of State must consult with such persons as he considers appropriate. The power reflects a recommendation by the Law Commission in its 1997 report on shareholder remedies in respect of analogous shareholder actions in Scotland. Under *subsection (7)*, the regulations will be subject to the affirmative resolution procedure.

Section 264: Application for permission to continue derivative claim brought by another member

503. This section addresses the possibility that, where the court has already decided that there is an appropriate case for a derivative claim and a member has commenced or continued a claim:

*These notes refer to the Companies Act 2006 (c.46)
which received Royal Assent on 8 November 2006*

- the manner in which the member commenced or continued the claim may amount to an abuse of the court (e.g. the member brought the claim with a view to preventing another member from bringing the claim);
 - the member may fail to prosecute the claim diligently;
 - it may be appropriate for another member to continue the claim (e.g. because the member who brought the claim has become very ill).
504. The section provides that, in these circumstances, another member may apply to the court to continue the claim as a derivative action.

Chapter 2: Derivative Proceedings in Scotland

505. Sections 265 to 269 seek to ensure maximum consistency between the position in England and Wales and Northern Ireland and the position in Scotland (although the clauses reflect the different procedural requirements which apply where proceedings are commenced in the Scottish courts, in particular the fact that the leave of court must be obtained before derivative proceedings may be raised). In view of this, they also put the rights of the member to raise actions on behalf of the company on a statutory footing.
506. Section 265 differs from section 260 in its approach in that it confers the right to bring the proceedings in the first place, and then, in the clauses which follow, regulate the proceedings. (By contrast, the sections relating to proceedings in England and Wales and Northern Ireland assume that there is already a right to bring such proceedings in England and Wales and Northern Ireland; they therefore regulate the proceedings rather than confer the right to bring them.)
507. Subsections (4) to (6) of section 268 confer on the Secretary of State a parallel power to that in section 263 to make regulations with regard to the criteria to which the court must have regard in determining whether to grant leave to continue a derivative claim and where leave of the court must be refused.

Part 12: Company Secretaries

Section 270: Private company not required to have secretary

508. This section replaces section 283(1) of the 1985 Act insofar as it applies to private companies. It implements the CLR recommendation (Final Report, paragraph 4.7) that the requirement for a private company to have a secretary be abolished. It defines a private company “without a secretary” for the purposes of the Act as a company which has taken advantage of the exemption provided by subsection (1) as opposed to one which normally has a secretary but for some reason (for example the death of the office holder) is without a secretary at a given time. Subsection (3) makes provision for private companies without a secretary.

Section 271: Public company required to have secretary

509. This section replaces section 283(1) of the 1985 Act insofar as it applies to public companies. It retains the requirement that a public company must have a secretary. The secretary may also be one of the directors.

Section 272: Direction requiring public company to appoint secretary

510. This section is a new provision, enabling enforcement of the continuing requirement for a public company to have a secretary. It does not apply to private companies. Where it appears that a public company does not have a secretary, the Secretary of State may give a direction to the company. The company must comply with the direction (by making the appropriate appointment and giving notice of it) within the period specified in the direction. The section provides for an offence for failure to comply with a direction.

Section 273: Qualifications of secretaries of public companies

511. This section updates section 286 of the 1985 Act. It makes it the duty of the directors of a public company to ensure that the secretary has both the necessary knowledge and experience and one of the qualifications listed in *subsection (2)*. The qualifications specified in this section are the same as in the 1985 Act except that:

- they do not include the qualification of having held the office of the company's secretary (or assistant or deputy secretary) on 22 December 1980;
- in *subsection (3)(f)*, "Chartered Institute of Management Accountants" replaces "Institute of Cost and Management Accountants" as the Institute changed its name in 1986.

There is no requirement for the company secretary to be a natural person. (Compare the requirement in section 155 that a company must have at least one director who is a natural person.)

Section 274: Discharge of functions where office vacant or secretary unable to act

512. This section replaces section 283(3) of the 1985 Act. It provides for the situation where the office of secretary is vacant or there is no secretary capable of acting for any other reason. In these circumstances, if the company has an assistant or deputy secretary, then that person may fill the position of secretary; if not, any person authorised by the directors may do so. This section differs from section 283(3) of the 1985 Act by permitting the directors to authorise any person to act as secretary, rather than only an officer of the company.

Section 275: Duty to keep register of secretaries

513. This section replaces the requirement in section 288 of 1985 Act. It requires every company to keep a register of its secretaries containing specified details. *Subsection (3)* provides that the register must be kept available for inspection either at the company's registered office or at a place specified in regulations made under section 1136. *Subsections (5) to (8)* retain the public right of inspection, sanctions and means of enforcement of the right of inspection.

Section 276: Duty to notify registrar of changes

514. This section replaces the requirement in section 288(2) of the 1985 Act. It requires notification to the registrar within 14 days of any change in the company's secretary or any change in the particulars contained in the register of secretaries. The consent of the person having become a secretary or joint secretary of a company must accompany the notice. The section retains the existing sanction and ensures that the public record is kept up to date as regards the secretary of every company.

Section 277: Particulars of secretaries to be registered: individuals

515. This section replaces section 290 of the 1985 Act insofar as it applies to secretaries who are individuals. It requires a company to enter in its register of secretaries the name and address of any individual who is its secretary. The definition of name is the same as for directors (see section 163): in particular, the register must include any name used or in use for business purposes since the age of 16. The section retains an exception relating to the former names of peers but, as recommended by the CLR, not that for the former names of married women. The address to be registered is a service address: this implements the CLR recommendation (Final Report, paragraph 11.46) that the requirement for home addresses for company secretaries be abolished.

Section 278: Particulars of secretaries to be registered: corporate secretaries and firms

516. This section replaces section 290 of the 1985 Act insofar as it applies to secretaries who are not individuals. It sets out the details which must be registered where the secretary of a company is either a body corporate or a firm which is a legal person under the law by which it is governed. The requirements that apply in the case of an EEA company follow the recommendations of the CLR (Final Report, paragraph 11.39).
517. The section also makes provision about the details which must be registered where all the partners in a firm are joint secretaries.

Section 279: Particulars of secretaries to be registered: power to make regulations

518. This section is a new provision. It provides a power for the Secretary of State to make regulations that add or remove items from the particulars that have to be entered in a company's register of secretaries. A similar power is provided by section 166 for directors' particulars.

Section 280: Acts done by person in dual capacity

519. This section replaces section 284 of the 1985 Act. It provides that where a provision requires or authorises a thing to be done by or to both a director and a secretary of a company it will not be satisfied if done by the same person acting in both capacities.

Part 13: Resolutions and Meetings

520. The provisions in this Part replace most of Chapter 4 of Part 11 of the 1985 Act on meetings and resolutions. The changes in the law derive principally from the CLR's consultation on "Company General Meetings and Shareholder Communications" and recommendations from Chapters 2, 6 and 7 of their "Final Report", together with two subsequent consultations; the Modernising Company Law White Paper of July 2002 and the Company Law Reform White Paper of March 2005.
521. In addition to implementing detailed policy changes, Part 13 implements two general changes.
- First, the law makes the current "elective" regime the default for private companies. This means, for instance, that private companies will no longer need to "elect" to dispense with the Annual General Meeting (AGM): they will not be required to hold an AGM in the first place.
 - Second, the current law is drafted on the basis that the main way in which shareholder decisions are taken is in general meetings. The new provisions proceed on the basis that in future this will not be the case for many private companies. Private companies will not be required in future to hold general meetings; instead provision is made for new procedures for decisions to be taken by written resolution.
522. The law relating to decisions has been restated in a way that deals first with private companies. Additional layers of requirements for public and quoted companies holding general meetings follow in subsequent provisions. There are provisions at the end of the Part about record keeping. In general, where this Part imposes an obligation or confers a power, it will apply notwithstanding anything in the articles unless otherwise indicated.

Chapter 1: General Provisions about Resolutions

Section 281: Resolutions

523. This section provides that members' resolutions can only be passed in accordance with the provisions of this Part. There is no equivalent in the current legislation. *Subsection (1)* allows a private company to pass a resolution either as a written resolution or at a meeting of the members. *Subsection (2)* allows a public company to pass a resolution only at a meeting of the members. *Subsection (3)* ensures that where a resolution is required but the type of resolution is not specified, the default will be an ordinary resolution unless the articles require a higher majority. When a provision specifies that an ordinary resolution is required, the articles will not be able to specify a higher majority. *Subsection (4)* preserves the common law unanimous consent rule.

Section 282: Ordinary resolutions

524. This section provides a definition of an ordinary resolution, whether of the members generally or of a class of the members and whether as a written resolution or as a resolution passed at a meeting. A simple majority – that is, over 50% – is required.

Section 283: Special resolutions

525. This section provides a definition of a special resolution, whether of the members generally or of a class of the members and whether as a written resolution or as a resolution passed at a meeting. A 75% majority is required. If a resolution is proposed as a special resolution, there is a requirement to say so, either in the written resolution text or in the meeting notice. Where a resolution is proposed as a special resolution, it can only be passed as such. The main difference from the existing definition in section 378(2) of the 1985 Act is that there is no longer a requirement for 21 days' notice where a special resolution is to be passed at a meeting. The subject matter of section 378(3) of the 1985 Act is now dealt with *in* section 307(4) to (6) (notice required of general meeting), while the subject matter of section 378(4) and (6) is dealt with in sections 320 and 301 respectively.

Section 284: Votes: general rules

526. This section sets out the general rules on votes of members taken by written resolution, on a show of hands at a meeting or on a poll taken at a meeting. These are adapted from section 370 of the 1985 Act and the default regulations in Table A. *Subsection (4)* allows these general rules to be varied by the company's articles.

Section 285: Votes: specific requirements

527. This section sets out specific requirements on votes of members, which the company's articles may not override. *Subsections (1) and (2)* provide for entitlement to vote where proxies have been appointed and ensure that the articles do not disadvantage a member voting by proxy or proxies. *Subsection (3)* makes new provision for voting rights on written resolutions, reflecting the fact that they will no longer need to be passed unanimously. A member will have the same number of votes whether passing a resolution on a poll in general meeting or on a written resolution.

Section 286: Votes of joint holders of shares

528. This section puts on a statutory footing what was a default regulation under article 55 of Table A on votes of joint holders of shares. The person whose vote counts is the "senior" holder, the joint holder whose name appears first in the register of members

Section 287: Saving for provisions of articles as to determination of entitlement to vote

529. This section makes new provision to preserve the right for a company to require objections to votes to be made in accordance with procedures in their articles. If an objection is overruled, the decision will be final except in cases of fraud and certain other kinds of misconduct detailed in case law where a court may intervene. This provision preserves the current law. The provision ensures, on the one hand, certainty for company by enabling the chairman to settle matters relating to the admissibility of votes in accordance with the articles and, on the other hand, sufficient remedies for members to challenge a decision if they have suffered unfair prejudice.

Chapter 2: Written Resolutions

530. The provisions of this Chapter replace the present rules on written resolutions of private companies. A key change (apparent from sections 282 and 283) is that where the statutory procedure under the 1985 Act requires unanimity, the procedure in this Act does not. Consequently, the sections are more detailed than sections 381A to 381C of the 1985 Act and set out the procedures for decisions taken outside of a general meeting framework. The use of the expression “written resolution” does not mean that there is a requirement for “writing” in the sense of hard copy.